Magyar Telekom

Full Year 2006 Results Conference Call

February 13, 2007 at 16:00 CET

Conference call operator introduces call

Chris Mattheisen remarks

Good afternoon, ladies and gentlemen and welcome to Magyar Telekom's full year 2006 results conference call. I am Chris Mattheisen, Magyar Telekom's Chairman and Chief Executive Officer since last December, and I am hosting today's call together with Thilo Kusch, our CFO.

Before going through the analysis of the fourth quarter results, I would like to give you an overview on the full-year financials and an update on our public targets.

We have announced solid performance for 2006, exceeding our public targets in terms of revenue and EBITDA growth, as well as achieving a lower than targeted capex to sales ratio. The higher than forecasted revenue increase is primarily explained by the finance lease treatment of the EDR service and the consolidation impact of the Hungarian IT and system integration company KFKI. For the EDR project we have accounted 20 billion forints in additional revenues in 2006, which by itself results in more than 3% revenue growth over the previous year.

Reported EBITDA grew by close to 1%, versus our flat EBITDA guidance. Excluding the investigation costs, EBITDA increased by over 2%. The capex to sales ratio was 13.5% last year, significantly below the targeted ratio of 15%, mainly driven by the higher revenues. Operationally, we were not quite able to achieve our goal in terms of broadband connections, reaching 95% of the targeted number, which could negatively impact our expected 2007 growth.

With regard to our public targets for 2007, the revenues accounted last year for the EDR service, mean that revenue growth opportunities for 2007 are somewhat limited. We have therefore revised our revenue target originally announced last year, and now expect flat revenues for this year. We would like, however, to draw your attention to the fact that flat revenues in 2007 would still deliver a 4.5% compound average revenue growth rate over 2005, in line with the originally announced above 3% revenue growth for both 2006 and 2007.

On an EBITDA level, the previous growth target in forint terms had to be reviewed and changed to a flat target for this year. The reason for the revision is mainly the impact of the Hungarian austerity package, which we believe will have a more negative impact on our profitability than previously expected, through increased wage taxes, higher costs due to strengthening inflationary pressure and decreased disposable household income. Another contributing factor to the lower EBITDA level is the finance lease treatment of the EDR project, as part of the revenue is accounted as interest income. Furthermore, investments in EDR equipment are reported as cost of telecom equipment sales instead of depreciation, further reducing our EBITDA. We estimate that the negative impact of the EDR finance lease treatment on 2007 EBITDA might even exceed 3 billion forints. Although the benefits of the fixed-mobile integration will continue to come through, they are not expected to fully compensate for these negative effects. In terms of the Capex to sales ratio, however, we are maintaining our original target of below 14%.

Regarding our strategy going forward, I would like to confirm that we intend to maintain the overall direction that the Group is currently following. We will, however, be putting a strong focus on service quality and increased efficiency. We aim to do this by making improvements in the operational cost structure, headcount productivity and leveraging new, integrated revenue opportunities. Last but not least, our goal remains to seek growth in the form of value-creating acquisitions in the future both in Hungary and in our region.

Before going on to the segment results, let me also mention an important event in the fourth quarter, although this was not closely related to our financial performance. 2006 was overshadowed by the investigation into certain contracts, which delayed the publication of our 2005 audited annual report. However, based on a report prepared by the investigator, the auditor and the general meeting held on 21st of December 2006 were able to approve the 2005 financials of the Group and the dividend proposal. The 70 forint per share dividend plus a 3 forint per share compensation for late payment was distributed to our shareholders starting 12th of January this year.

Now let me start the segmental analysis with the Hungarian fixed line operations. Fourth quarter revenues show an almost 7% increase compared to the same period of 2005. This outstanding performance is a result of the KFKI and Dataplex acquisitions and our focus on broadband revenues, which were able to counterbalance the ongoing drop in traffic revenues.

In the traditional voice market, mobile, cable and alternative providers still remain the main competitors. To protect our customer base, we are continuously migrating customers to flat-rate packages with a loyalty period. As a result, the ratio of customers on a fixed-term contract was above 40% in the residential segment by the end of the year.

Total traffic minutes have slightly decreased during the year. However, thanks to the flat rate offers we see an upward trend in the residential segment. Here, domestic minutes increased by 11%, mainly driven by increased long distance calls. Subscription revenues also increased somewhat as a result of these packages.

The revenue contribution of internet and data services reached 19 billion forint in the fourth quarter, adding up to 25% of the overall Hungarian fixed line revenues. Although we did not reach our ambitious target for broadband access by the end of last year, as, at the current price levels, the demand was somewhat lower than estimated, the number of broadband customers still increased by 60% year-on-year. We aim to further increase broadband penetration this year through new offers and increased bandwidth. We also launched IPTV services in November last year further improving our service portfolio and competitiveness.

System integration and IT revenues grew dynamically to almost 12 billion forint in the last quarter thanks to the consolidation of Dataplex since April and KFKI since mid-September. Through these companies, we gained a strong position in the growing IT, system integration and telco-outsourcing market. This year it will be further strengthened by the operations of T-Systems Hungary, of which we gained control on January 1st 2007.

A further success of the period was that - together with T-System Enterprises - we signed a 5-year info-communication and telco outsourcing contract with Allianz Group for 6 Central-Eastern-European countries. According to the contract, we will be responsible for building out the operation in Hungary and Romania and will be in charge for managing the complete regional system from this year onwards.

On the cost side, the costs related to the investigation, the bookings related to the Universal Telecommunication Support Fund and most importantly the consolidation impact of our new subsidiaries put pressure on the fourth quarter margins. Consolidation of the new IT and system-integration subsidiaries has significantly increased the cost base, mainly through maintenance and subcontractor fees, diluting our margin. Consequently, quarterly EBITDA margin declined to 27%.

(Pause)

Let me now hand over to Thilo, who will continue with the analysis of the international fixed-line operations and the mobile segment.

Thilo Kusch remarks

Thanks, Chris.
Good afternoon ladies and gentlemen!

Continuing with the performance of the international fixed line operations, the close to 6% growth in revenues in the fourth quarter of 2006 is attributable to the favourable FX impact, the improvement in the Montenegrin fixed line operations and the contribution of our operations in Romania and Bulgaria. Despite growing revenues, EBITDA decreased due to the headcount reduction related expenses accounted mainly at the Montenegrin fixed line operations.

In Macedonia the quarter-on-quarter revenue decrease of 2% was driven by the decline in outgoing traffic revenues, partly offset by increasing broadband and incoming traffic revenues. On the cost side, the 20% EBITDA increase is due to the previous year's 1.5 billion forint headcount reduction related expenses that were accounted for in relation to the redundancy of 550 employees in the fourth quarter of 2005. We have also booked 0.6 billion forint severance expenses in the fourth quarter of 2006. Excluding these items, EBITDA decreased by 4% and the margin was 44% in the fourth quarter last year.

With regard to liberalization, the first reference interconnect offers were signed with On.net in November and with Akton in December 2006. On.net, owned by Telekom Slovenia, was already a competitor providing leased line, dial-up and wireless broadband services and has now started to offer call-by-call and preselection services through MakTel's network. We expect further operators to conclude reference interconnect offer agreements with MakTel this year. In addition, some are also likely to sign international call termination agreements, which may further jeopardize parts of our revenue stream.

Turning to Montenegro, I would like to inform you that, in response to the findings of the investigation, key measures have been taken to enhance controls, compliance and corporate governance procedures across the whole Magyar Telekom Group. Furthermore, Telekom Montenegro has fully integrated fixed and mobile operations to increase efficiency. As a result, the two operations share, for example, a common sales and distribution network, procurement processes and network development.

The reorganisation gave scope for further headcount reduction, for which an agreement was reached with the labour union. As a result, the company accounted 2.5 billion forints of accruals for severance payments in December. More than 20% of the company's headcount will be cut during the first half of this year, the majority at the fixed line operations.

The fixed line business, operating under the T-Com brand, showed a 12% revenue increase, driven by the growing wholesale and internet revenues as a result of the rapidly increasing number of DSL customers. Although fixed to mobile substitution already puts pressure on fixed line traffic, the company was successful in line preservation, and the total number of lines has slightly increased. Excluding the cost of the headcount reduction, EBITDA margin was around 40% in the fourth quarter.

Moving on to the Hungarian mobile market, penetration growth was again strong during the Christmas period with penetration levels reaching 99% by the end of the year. Although the market share of T-Mobile Hungary slightly decreased in 2006, the company showed the highest customer increase based on active customers during the year. The portion of T-Mobile's customers who have not used their mobile phones for more than three months decreased to around 5% by the end of the year, the lowest level within the Hungarian mobile market. The successful sales activity was supported by the fixed-mobile integrated shop network and marketing activities. In addition, new internet subscriptions played a significant role, thanks to the HSDPA service launched in May 2006.

T-Mobile was the first and is still the only operator in Hungary to offer HSDPA services. By the end of December, the service was available in 23 cities covering about 28% of the Hungarian population. The network offers speed of up to 3 megabit per second. In order to boost mobile-internet usage, T-Mobile launched several offers bundling 3G or HSDPA enabled handsets and notebooks with internet subscription. The notebook offer was particularly popular. By the end of December, T-Mobile sold almost 6,000 notebooks with mobile broadband subscription.

Looking at our financial performance, revenues showed 22% growth in the fourth quarter last year, reflecting the impact of the EDR project, which added 9.3 billion forints to fourth quarter revenues. Of this, 1.1 billion was accounted as service revenues and the rest as other revenues and at the same time cost of equipment sales, in line with the financial lease treatment. Organic revenues without EDR were up by 8% in the last quarter compared to the same quarter of 2005, driven by higher enhanced service and equipment sales revenues.

Despite a steady tariff decrease due to customer migration and the increasing number of closed user groups, thanks to the high price elasticity, the tariff decrease was largely offset by the increase in usage, resulting in broadly flat ARPU levels.

On an EBITDA level, the accounting changes related to payments into the Universal Telecommunication Support Fund also somewhat distorted the figures. Without this change and the EDR project, EBITDA increased by 5% with a margin of close to 38% in the fourth quarter.

Continuing with the international mobile operations, let me start with the Macedonian mobile market.

Mobile penetration in Macedonia reached 68% by the end of 2006, nearing saturation point. Thanks to the rebranding campaign launched last year, despite strong competition, the market share of T-Mobile Macedonia remained high at close to 67%. While tariff levels have been continuously decreasing, higher usage and a strong increase in value enhanced revenues kept ARPU levels flat. The company also places a strong emphasis on business client retention and on migrating prepaid to postpaid customers. As a result, the ratio of postpaid customers has been continuously increasing.

The strong increase in revenues was driven by the 8% higher customer level and also helped by the favourable foreign exchange impact. On the cost side, the company was very successful in improving efficiency resulting in flat operating expenses. As a result, EBITDA grew by 26% and the margin was above 55% in the fourth quarter of last year.

According to the recent announcement of the Macedonian government, Mobilkom, the mobile unit of Telekom Austria, has won a tender for the third mobile phone licence in Macedonia. Mobilkom was the only bidder and had offered 10 million euro for the 10-year licence. According to the licence agreement, the new operator has to launch service within six months and gradually increase coverage. There is no obligation for the existing mobile service providers to offer domestic roaming service to Mobilkom.

Moving on to the Montenegrin mobile market, where we also operate under the T-Mobile brand, we see the positive impacts of the rebranding campaign launched in the second half of last year. Thanks to increased marketing efforts and new offers, our postpaid market share reached an all time high of 47% compared to 42% in 2005. Our blended market share also increased in the fourth quarter of last year.

T-Mobile Montenegro's high penetration growth to almost 130% can be explained by the extended availability of SIM cards, in line with other market offers. This change increased the reported number of customers and negatively affected revenue and usage per customer figures. Market share figures, which are calculated based on the active customer base, remain unaffected.

Revenues showed a 16% increase thanks to higher usage and also helped by the favourable foreign exchange movements. EBITDA margin was 28% in the fourth quarter, reflecting seasonality effects and higher marketing expenses. Last year significant investments were made to improve network quality and coverage. As a result, population coverage increased to 98% by the end of the year. We are also preparing for expansion into UMTS services, as the company is currently bidding for the third generation licence.

(PAUSE)

Chris Mattheisen remarks

That concludes the formal part of Magyar Telekom's conference call. Now we are happy to open the floor for questions. Operator, when you are ready, we will take the first question.

(Take questions)

I believe we have time for one more question.

(Take final question)

This is all the time we have. If there are follow-up questions, I encourage you to contact our Investor Relations team. The telephone number is 36-1-458-0424 or if you want to send an e-mail you can address it to investor.relations@telekom.hu. I would like to inform you that the transcripts of our conference calls will be available on our official website.

Thank you again for joining us today, and for your continued interest in Magyar Telekom.